

Atradius Country Report

Czech Republic – June 2010



Overview

General information

Capital:	Prague
Government type:	Parliamentary democracy
Currency:	Czech Koruna (CZK)
Population:	10.3 million
Status:	Upper middle income country (GDP/capita: US-\$ 18,037 in 2010)

Most important sectors (% of GDP, 2009)

Services:	62 %
Industry:	35 %
Agriculture:	3 %

Main import sources (2009, % of total)

Germany:	26.6 %
China:	10.0 %
Poland:	6.4 %
Slovakia:	5.4 %

Main export markets (2009, % of total)

Germany:	32.3 %
Slovakia:	9.0 %
Poland:	5.8 %
France:	5.6 %

Main expenses of foreign exchange

Machinery and transport equipment, and other manufactured items

Main sources of foreign exchange

Industrial products (machinery and equipment 56 %), tourism, foreign investments

Key indicators

	2007	2008	2009	2010*	2011*
GDP (US-\$ million)	174,214	216,085	190,274	183,981	185,431
Real GDP growth (%)	6.2	2.4	-4.2	0.9	3.0
GDP per capita (US-\$)	16,963	20,938	18,654	18,037	18,180
Inflation p.a. (%)	2.9	6.4	1.1	1.5	1.8
Fiscal balance (% of GDP)	-0.7	-2.7	-5.9	-5.6	-4.8
Total foreign debt (US-\$ million)	74,702	80,800	82,200	86,300	89,900
Foreign debt/GDP (%)	43	37	43	47	48
Foreign debt/XGS (%)	51	46	60	59	57
Short-term debt/inter. reserves (%)	69	64	43	41	49
Debt service ratio (%)	10	10	14	11	10
Current account balance (US-\$ m.)	-5,755	-6,631	-2,200	-4,300	-5,200
Current account/GDP (%)	-3.3	-3.1	-1.2	-2.3	-2.8
Nom. exchange rate to US-\$ (average)	20.29	17.07	19.06	19.87	20.53
International reserves (US-\$ million)	33,486	37,625	40,475	39,933	41,200
In months of merchandise imports	3.4	3.2	4.7	3.5	3.8

*forecast

Source: Economist Intelligence Unit (EIU)/International Monetary Fund (IMF)

Political situation: A new centre-right coalition government?

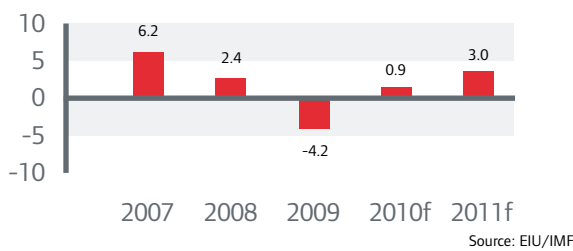
Head of state: President Vaclav Klaus.(since March 2003)
Head of government: Prime Minister Jan Fischer (since April 2009)
Form of government: Non-partisan caretaker government

Internal situation

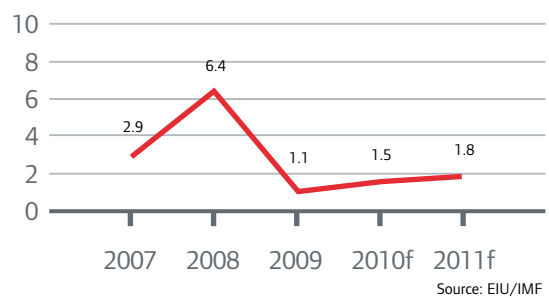
After four years of political deadlock and weak governments (the current administration is a non-partisan caretaker government), the results of the May 2010 election to the lower house provide the opportunity for setting up a new coalition government. While the left wing Social Democrats won most votes in the election (22 %, 56 of 200 seats), three centre-right parties (ODS: 53 seats, TOP 09: 41 and VV: 24) have begun negotiating for a coalition that could count on a majority of 118 of the 200 seats in parliament.

Internal economic situation: Slow recovery from the recession

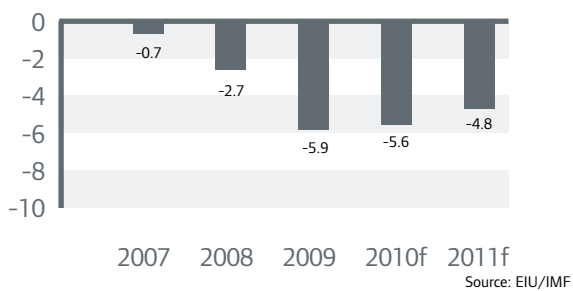
Real GDP growth (%)



Inflation p.a. (%)



Fiscal balance (% of GDP)



General situation

From 2005 to early 2008, rapidly rising exports and dynamic domestic demand, driven by higher wages and more commercial bank lending to both consumers and investors, resulted in annual GDP growth of around 6%. All sectors contributed to this favourable macroeconomic environment: especially manufacturers exporting to Europe (automotive, machinery, chemicals etc). Years of high foreign direct investment (FDI) provided the country with a competitive and vibrant export sector. But this advantage turned into a weakness as the open, export-oriented Czech economy was hit by the recession in the eurozone and Eastern Europe, with a drop in production of 19% and GDP declining by 4.2% in 2009. Less FDI and lower private consumption (the result of reduced access to bank loans) also contributed to the economic slump.

Since the end of 2009, the economy has started to pick up again, mainly thanks to a recovery in exports, which have been growing continuously since November 2009 and increased 11.1% in the period January to April 2010. However, the economic recovery is still very modest, with demand from the main EU markets low and domestic demand about to decrease again. The registered unemployment rate rose again in Q1 of 2010 - to 9.7% - and domestic household and corporate spending remains subdued because of the scarcity of bank loans. The construction sector is still the economy's problem child, with output continuing to decrease year-on-year in April 2010 (by 15.3%). As a result, for 2010, GDP growth of just 0.9% is forecast.

After an increase to 6.4% in 2008, inflation has decreased sharply - to 1.1% in 2009 - due to lower import prices and weaker domestic demand, and is expected to stand at 1.5% this year, still below the Central Bank's target of 2%.

From a sector perspective, companies in textiles, transport, construction, automotive, machines, furniture and chemicals are having the most difficulty accessing bank loans. Business and household bankruptcies increased sharply in 2009, and have continued to rise in early 2010. This has burdened banks' non-performing loans (NPL) portfolios. However, only 15% of those loans are foreign exchange-denominated, so the mainly foreign-owned banking sector (95%) continues to be healthy.

Economic policy

The Czech Republic's public finances are stable, with only moderate public sector debt (40% of GDP), but a new government will have to raise taxes and curb government spending to reduce the increased budget deficits of nearly 6% of GDP in 2009 and more than 5% of GDP in 2010. These deficits are far too high to comply with the EMU criteria for joining the eurozone, but in any case that entry will be delayed because of the current lack of popular support.

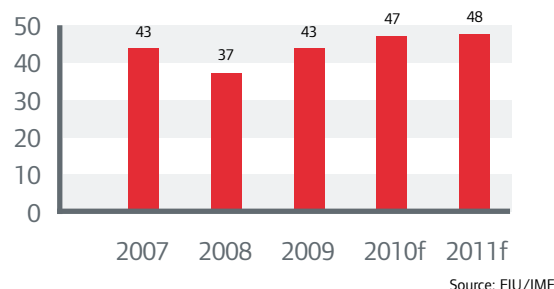
Since mid-2008, the Czech National Bank (CNB) has eased its monetary policy, lowering the key interest rate to 0.75% (even lower than the European Central Bank's rate of 1%). Euro-sceptic Czech president Klaus has repeatedly meddled in CNB affairs, thus undermining the central bank's autonomy.

Energy situation

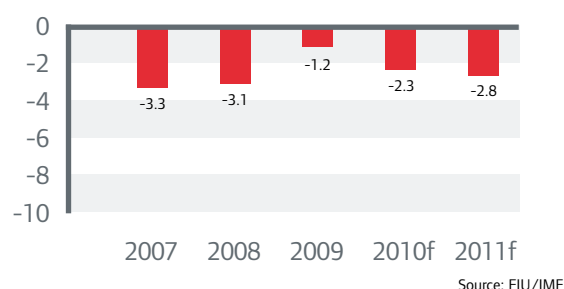
Quite bad: some coal deposits.

External economic situation: Good liquidity and solvency position

Foreign debt/GDP (%)



Current account/GDP (%)



Foreign debt

- Level:** Despite a strong increase until 2008, this is still relatively low (47 % of GDP, 59 % of exports of goods and services in 2010)
- Structure:** A high share of foreign debt is contracted by the corporate and the banking sector. Large short-term share
- Debt service ratio:** Low: approximately 10 %, including short-term debt of approximately 30 % in 2010

Remarks:

Compared to other Eastern European countries, the Czech Republic still has one of the lowest bond spreads and one of the best sovereign ratings.

Balance of payments

- Trade balance:** Positive
- Current account:** Moderate deficits (2-3 % of GDP in 2010 and 2011)
- Capital account:** Very large surpluses. Decreased in 2008
- Total Account:** Positive in 2010

Remarks:

The external figures are sound. In 2009 imports fell faster than exports, resulting in a lower current account deficit (-1.2 % of GDP). The trade surplus compensates for high profit remittances to foreign investors. Normally, the moderate current account deficits are quite easily financed by investment-related / portfolio capital inflow, but the credit crisis temporarily hampered fresh FDI and other capital imports in 2009. After a high in mid-2008, the koruna exchange rate has fallen by around 10 % against the euro. However, this has been more a reflection of weakened market sentiment towards the whole Eastern European region than a negative perception of the Czech Republic itself. In the last few months, tensions have abated, underpinning the koruna exchange rate again.

International reserves

- In months of imports (cif):** Stable, at more than 3 months.

Prospects: Persisting strong economic fundamentals

Political situation

Coalition talks between the three centre-right parties are ongoing, but it is likely that the new government will be agreed on before mid-July. Despite its ample majority in parliament, the new coalition's stability and efficiency could be disrupted as two of the three parties (TOP 09 and VV) are newly established and have no political experience.

Internal economic situation

After a 0.9% rebound this year, GDP growth is projected to recover further in 2011 (3%), but this depends largely on a further upswing in export markets (especially automotive demand from Russia and Asia). The parties of the new coalition government have announced an immediate start on a new budget, with the aim of cutting the budget deficit to 3% of GDP by 2013.

Payment behaviour deteriorated during the economic crisis, especially in the construction, transport and textile sectors, and we do not expect a major improvement in the next 6 months.

External economic situation

Its good liquidity and solvency position are shielding the country from potential external funding problems. Despite some vulnerability to global market sentiments, we do not expect the koruna to fall victim to extreme volatility. With eurosceptic sentiment in both political and public circles, entry to the eurozone is unlikely before 2016.

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